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April 23, 2004

Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station, 2<sup>nd</sup> Floor  
Boston, Massachusetts 02110

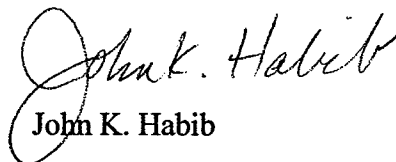
Re: Southern Union Company, D.T.E. 04-41

Dear Ms. Cottrell:

Enclosed please find the responses of Southern Union Company ("Southern Union" or the "Company") to information requests DTE-1-11 and DTE-1-17. This filing completes the Company's responses to the Department of Telecommunications and Energy's First Set of Information Requests in this proceeding.

Thank you for your attention to this matter.

Sincerely,



John K. Habib

Enclosures

cc: Elizabeth Cellucci, Hearing Officer  
Kevin Brannelly, Director, Rates and Revenues  
Paul E. Osborne, Assistant Director of Rates and Revenues  
Glenn Shippee, Rates and Revenues  
Jim Powell, Rates and Revenues  
Rebecca Hanson, Assistant General Counsel  
Richard Marshall

Information Request DTE 1-11

Refer to page 15, line 9 of Mr. Marshall's testimony. Please provide workpapers and supporting documentation for the \$8,173,000 in unregulated inventories referenced therein.

Response

Upon review, the Company has determined that the adjustment of \$8,173,000 listed as "unregulated operations" is actually an adjustment to remove from the net plant test certain amounts relating to materials and supplies that are held for the regulated gas companies and are booked to the gas inventory account, but are not includable in the net plant test. Specifically, the amount listed for "regulated inventories" totals \$230,854,000, which includes natural gas storage for regulated companies of \$222,681,000 and materials and supplies of \$8,173,000. Because the book value of materials and supplies are not included in the net plant test, the Company backed this amount out of the total gas inventory amount for regulated gas companies. As the attached spreadsheet shows, there are no amounts associated with "unregulated" gas inventories in the net plant calculation.

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Information Request DTE 1-17

Refer to page 8, line 3 of Mr. Marshall's testimony. Please indicate if the Company's bond ratings by any of the ratings agencies listed changed in 2002, 2003 or in 2004 and please provide copies of the announcements issued by the rating agency, if applicable.

Response

Southern Union Company's senior unsecured debt is currently rated BBB, BBB and Baa3 by Standard & Poors, Fitch Ratings and Moody's Investors Service, respectively.

In March 2003, the S&P rating was lowered from BBB+ to BBB. In June 2002, the Moody's rating was lowered from Baa2 to Baa3. In May 2002, the Fitch rating was lowered from BBB+ to BBB. No other changes in ratings have occurred during the period from January 1, 2000 through the date of this response.

Attached are copies of the ratings change announcements from Moody's, S&P and Fitch.



**Moody's Investors Service**  
Global Credit Research

Fundamental Credit Research  
Rating Action  
Published 3 Jul 2003

## **Panhandle Eastern Pipe Line Company**

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## **MOODY'S UPGRADES THE DEBT RATINGS OF PANHANDLE EASTERN PIPE LINE COMPANY (TO Baa3 SR. UNS.); SOUTHERN UNION COMPANY'S RATINGS CONFIRMED (Baa3 SR. UNS.); BOTH OUTLOOKS NEGATIVE**

**Approximately \$2.2 Billion of Debt Securities Affected**

Moody's Investors Service upgraded Panhandle Eastern Pipe Line Company's (PEPL) senior unsecured debt ratings to Baa3 from Ba2 and its senior unsecured shelf ratings to (P)Baa3 from (P)Ba2. PEPL's Ba2 senior implied rating is withdrawn. The rating outlook is negative. At the same time, Moody's confirmed the debt ratings of Southern Union Company (SUG) (at Baa3 senior implied) and changed the outlook to negative.

These rating actions end the review for direction uncertain that was initiated when SUG announced it would acquire PEPL from CMS Energy Corporation (B2 senior implied/stable outlook) for an enterprise value of \$1.8 billion. This acquisition was recently consummated.

The upgrade reflects the stronger credit profile of SUG, PEPL's new owner, and the financing of this acquisition, which has proven to be neutral to PEPL's financial position. PEPL's ratings indicate: 1) the low business risk of this regulated gas transmission company; 2) earnings stability, with revenues underpinned by flat reservation fees and long-term contracts with a diverse group of creditworthy shippers; 3) a mature asset given some upside by its subsidiary Trunkline LNG Holdings, LLC's (LNG) LNG facility; and 4) a measure of credit protection provided PEPL by restricted payments in its indenture, though it still leaves abundant capacity to make a large dividend to SUG.

However, PEPL's ratings are restrained by: 1) higher leverage and weaker coverage measures relative to many of its pipeline company peers; 2) the prospect of increased capital spending and debt over the medium term from its LNG facility's upcoming \$150 million expansion project; 3) a competitive environment that has caused persistent discounting from the pipeline's allowed tariffs, pressuring its ability to earn its allowed returns; above-average re-contracting risk from shorter than industry average contract life of 3 years; and 4) an operating record that has yet to be established under SUG's ownership.

Moody's is also changing its rating outlook on SUG from stable to negative reflecting our expectation that SUG's debt reduction progress might be slower than anticipated at the time the PEPL acquisition was announced. SUG originally planned to sell assets from PEPL and to apply the proceeds toward its financial de-leveraging objectives. In addition, SUG had planned that approximately 25% of the purchase price would be funded by AIG Highstar Capital. The exit of AIG Highstar as a funding partner along with potential delays in de-leveraging will pressure SUG's debt protection measurements in the near term. The outlook will remain negative until SUG achieves its de-leveraging objectives and demonstrates improved returns from the combined companies.

The negative outlook for PEPL mirrors that for SUG, as the parent's efforts to de-leverage and to cut costs could have a credit impact on PEPL. Execution risk in integrating the two companies is notable, since the PEPL acquisition is the largest to-date for SUG, doubling its size and transforming it from a gas distributor to a more diverse gas transmission company. It is conceivable that over the medium term, SUG will consider further M&A activity not only to prune the debt heightened by this acquisition, but also to fine-tune its strategic focus.

Factors that could precipitate a downgrade for PEPL's ratings include: 1) an erosion in PEPL's profitability from lack of success in renewing contracts at current levels; 2) increased leverage from recurring shortfalls in operating cash flow or higher-than-expected expenditures; and 3) either an asset sale at PEPL that significantly reduces its operating cash flows or an acquisition at SUG which unduly increases the cash that PEPL upstreams to its parent. Conversely, PEPL's ratings or outlook could improve if there is a sustained improvement in its leverage and coverages.

#### Financial Analysis

Moody's expects PEPL's margins to remain relatively flat, though there could be some additional contributions from the LNG facility once the expansion is completed in 2006. Given the maturity of the assets, profitability could be reduced if costs are not contained. PEPL's transportation rates have been persistently below its maximum allowed levels, so that the company has been pressured in earning its allowed levels (11% ROE for the last twelve months ended 3/31/03 vs. 14% implicit in the last black box rate settlement).

PEPL has above-average leverage for a regulated gas pipeline with 63% debt-to-capital at March 31, 2003. High leverage results in below-average coverages (EBIT/interest in 2x range). Capital expenditures are manageable within internal cash, and PEPL has the capacity to generate free cash flow.

Moody's includes in the leverage analysis for PEPL the \$275 million of project finance debt at PEPL's Trunkline LNG Holdings subsidiary. While this debt is non-recourse to PEPL, Moody's considers this debt, as well as any additional debt that may be incurred for its \$150 million expansion project, on-credit to SUG for a number of reasons. It is likely that this project will have SUG's support, given the integration with its pipelines and potential distributions from the project. The project's strategic value is underscored by the current rosy outlook for LNG and a dearth of operational LNG facilities in the U.S.

Panhandle Eastern Pipe Line Company is a natural gas transmission and LNG terminaling company. It is a subsidiary of Southern Union Company, a gas distributor based in Wilkes-Barre, Pennsylvania.

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**Moody's Investors Service**  
Global Credit Research

Fundamental Credit Research  
Rating Action  
Published 6 Jun 2002

## Southern Union Company

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## **MOODY'S DOWNGRADED THE DEBT OF SOUTHERN UNION COMPANY (Baa3 SR. IMPLIED); OUTLOOK STABLE**

**Approximately \$664.5 Million of Debt Securities Affected.**

Moody's Investors Service downgraded the senior unsecured and senior implied debt ratings of Southern Union Company ("SUG") one notch to Baa3, its senior secured debt to Baa2, and Southern Union Financing I's backed preferred securities to Ba1. The outlook is stable.

The downgrade follows a review begun February 22, 2002. The rating action reflects the slower than expected progress and results in generating cash flows to pay down the high acquisitions debt contracted in the past few years. While SUG's Cash Improvement Plan and asset sales have helped alleviate its debt situation, their positive effects have not been sufficient to counteract the near doubling of long-term debt incurred in fiscal 2001 and the \$37 million in common-stock repurchase made in fiscal 2002. As a result, SUG's debt measures are not likely to come back in line with those of other similarly rated LDCs in the intermediate term. Due to large interest payments from high debt levels, coverages remain weaker than those of its Baa2 peers. Although SUG has taken initiatives to reduce debt, leverage remains high at around 68% and is unlikely to fall to the level of its peers in the near future. The company does not intend to issue equity in order to relieve its balance sheet leverage. While SUG's attempts to sell assets have been moderately effective to-date, Moody's expects that SUG will take much longer to sell its remaining non-core assets if it intends to realize full-value for those assets.

The warmer than normal weather has also stressed SUG's financial performance. A warm winter heating season pressured margins as only about 33% of SUG's overall customers have rates that are weather normalized. Although recently approved fixed base rate mechanisms have helped to stabilize earnings in Missouri and Pennsylvania, warmer than usual weather is expected to have a noticeable impact on earnings in fiscal year 2002. These pressures are likely to reappear in the event of an equally warm winter in 2003.

The outlook is now stable, as the new management appears to be committed to making a steady, though slow, progress in retiring high cost debt by applying cash flows derived from operations, incremental asset sales and avoiding cash dividends. Any deviation from this debt reduction program could negatively alter this stable outlook.

New Ratings are:

Southern Union Company - Baa2 senior secured debt; Baa3 senior unsecured debt; Baa3 senior implied ratings.



## **Southern Union Rating Affirmed; Outlook Revised to Negative**

Judith Waite, New York (1) 212-438-7677

NEW YORK (Standard & Poor's) March 5, 2004--Standard & Poor's Ratings Services said today that it affirmed its 'BBB' corporate credit rating on Southern Union Co. and its subsidiary, Panhandle Eastern Pipe Line LLC, and revised the outlook to negative from stable.

The company has \$2.5 billion of debt outstanding.

"The negative outlook reflects the execution challenges facing the company in achieving its commitment to rapidly deleverage," said Standard & Poor's credit analyst Judith Waite.

"Southern Union has been in an acquisitive mode for several years, which has resulted in significant swings in leverage. Going forward, the company will need to show sufficient balance sheet strengthening prior to consummating a future acquisition in order to maintain the current rating," continued Ms. Waite.

Southern Union's mid-2003 acquisition of Panhandle Eastern Pipe Line and its subsidiaries, Trunkline Gas Co. LLC and Trunkline LNG Co. LLC, and Panhandle Eastern Pipe Line's joint venture, Sea Robin Pipeline Co., resulted in a highly leveraged consolidated balance sheet.

Although Southern Union financed the acquisition with proceeds from the sale of Southern Union's Texas gas distribution business and the sale of common equity and convertible debt, Panhandle Eastern Pipe Line itself had \$1.2 billion debt. This drove Southern Union's total debt up to 72% of total capital at closing.

Management has committed to improve its balance sheet rapidly. It refinanced Panhandle Eastern Pipe Line's debt shortly after the acquisition, lowering interest expense by about \$6 million. In addition, the company issued \$230 million of noncumulative preferred stock, using proceeds to reduce debt.

Management expects cash from operations to improve by at least \$15 million through the successful integration efforts, including implementation of a new companywide information technology platform. This improvement in cash from operations, together with free cash flow, will be dedicated to debt reduction, as will the proceeds from any future sales of equity. Furthermore, the company is expected to continue its stock dividend policy allowing it to build equity through retained earnings.

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\*S&P Lowers Southern Union Rtg to 'BBB'; Off Watch

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NEW YORK (Standard & Poor's) March 7, 2003--Standard & Poor's Ratings Services today lowered the corporate credit rating on gas utility Southern Union Co. to 'BBB' from 'BBB+', and removed the rating from CreditWatch where it was placed on Dec. 23, 2002, when the company announced that it would purchase CMS Panhandle Pipeline Cos. (BB/Watch Pos/--). The purchase price is \$1.83 billion, including \$1.2 billion of debt. The outlook is now stable.

Pennsylvania-based Southern Union has debt totaling \$1.3 billion.

Southern Union, through a new subsidiary, Southern Union Panhandle, will acquire three gas pipelines, including Panhandle Eastern Pipeline, Trunkline Gas Co. and Sea Robin Pipeline, along with the Trunkline LNG facility. It is expected that AIG Highstar Capital L.P. will become a minority owner through an investment of non-voting preferred stock.

The corporate credit rating is assigned to the senior unsecured debt at Southern Union and will be assigned to the senior unsecured debt at Panhandle, when the transaction closes. Standard & Poor's does not view the senior unsecured debt as being disadvantaged by the \$115 million of secured debt at the Pennsylvania and New England utilities, so the unsecured debt rating is not rated a notch below the corporate credit rating. When the debt of the Pennsylvania and New England utilities was assumed by Southern Union, the mortgage indenture was closed. Conversely, because the collateral backing the

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**\*S&P Lowers Southern Union Rtg to 'BBB'; Off Watch**

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first mortgage bonds is more than twice the value of the debt, that rating is 'A-', two notches above the corporate credit rating. Southern Union's preferred stock is rated 'BB+'.

"Panhandle is a major acquisition for Southern Union, and adds a lot of debt to the balance sheet, but the acquisition is accretive to earnings and cash flow and positions the company for further debt reduction," noted Standard & Poor's credit analyst Judith Waite. "Management's plan for reducing debt seems reasonable, and management's intent to shore up the balance sheet is supported by the cash remaining in the company and not being paid out in dividends," she continued. Standard & Poor's expects to see significant debt reduction over the next two years.

The stable outlook for Southern Union is based on Standard & Poor's understanding that management will be taking the necessary steps to reduce debt and bring the capital structure in line with the target of 50% to 55% of debt. The interest coverage targets are around 2.5x for EBIT interest coverage and around 3.0x for funds from operations interest coverage. If the steps taken to achieve these targets are inadequate, the corporate credit rating will be lowered.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found

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on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); under Fixed  
Income in the left navigation bar, select Credit Ratings Actions.

Contact: Judith Waite, New York (1) 212-438-7677  
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Fitch Ratings Lowers Southern Union To 'BBB': Outlook Revised To Stable Page 1/4

Business Editors

NEW YORK--(BUSINESS WIRE)--May 20, 2002--Southern Union Co.'s (SUG) outstanding debt securities have been downgraded by Fitch Ratings as follows: \$671 million senior unsecured notes and debentures to 'BBB' from 'BBB+'; \$100 million trust originated preferred securities to 'BBB-' from 'BBB' and \$151 million first mortgage bonds to 'BBB+' from 'A-'. The Rating Outlook has been revised to Stable from Negative.

The rating action reflects a slower than anticipated recovery in SUG's credit profile following a series of acquisitions completed in September 2000, the vast majority of which were funded with bank debt. In addition, recent financial results have been impacted by warmer than normal weather during the 2001-2002 heating season. As a result, key credit protection measures continue to fall short of expectations for the current rating category. For the 12 month period ended March 31, 2002 EBITDA interest coverage approximated 2.2 times (x) versus a historical range of around 3.0x. Barring any further debt reduction beyond levels already achieved in 2002, this ratio could remain below

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**Fitch Ratings Lowers Southern Union To 'BBB': Outlook Revised**  
3.0x through 2003. A moderate concern is SUG's near term debt refinancing risk. However, Fitch does not currently anticipate that SUG will face any major obstacles in renewing its \$350 million bank term loan facility maturing in August 2002.

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Fitch believes that SUG's recently implemented cash flow improvement program underscores management's commitment to credit quality improvement. Specifically, SUG has implemented a series of cost reduction measures and has achieved its ultimate goal of improving pretax cash flow by \$50 million annually by June 2002. As part of the program, SUG has divested most non-core assets with proceeds used primarily for debt reduction. With the exception of SUG's Florida division (6,000 customers) which was divested during December 2001, none of SUG's core gas distribution operations have been earmarked for sale.

SUG's stable credit outlook is supported by the relatively predictable cash flow stream provided by its multi-state natural gas distribution business. The October 2000 acquisition of Providence Energy, Fall River Gas, and Valley Resources have strengthened SUG's operating profile through enhanced diversity of regulatory, economic, and weather risk profiles. In particular, SUG's expansion into colder northeastern U.S. markets should contribute to more stable throughput

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volumes and reduced performance volatility. From a strategic standpoint, Fitch expects SUG to continue to adopt a conservative approach with respect to acquisitions for the foreseeable future. This factor, combined with the aforementioned cash flow improvement plan and recent rate design changes in SUG's Missouri and Rhode Island jurisdictions should allow for a gradual improvement in SUG's credit profile.

--30--ac/sf\*

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